BLG Helps to Overturn Controversial Interest Act Decision

September 11, 2018

BLG represented ClearFlow Energy Finance Corp. before Ontario Court of Appeal

Toronto (September 11, 2018) — Borden Ladner Gervais LLP (BLG) is proud to announce it has successfully represented ClearFlow Energy Finance Corp. (CEF) in a significant case before the Ontario Court of Appeal. BLG's Barry Bresner and Graham Splawski acted for CEF to overturn a lower court decision which had interpreted Section 4 of the *Interest Act* in a way that caused considerable uncertainty across the Canadian commercial lending industry.

CEF had financed the operations of Solar Power Network Inc. (SPN) through a complex series of loan agreements and promissory notes. The loans went into default and, although SPN executed forbearance agreements acknowledging the indebtedness, SPN later took the position that an Administration Fee and a Discount Fee charged by CEF constituted interest and, as those fees were not stated at an annual rate or percentage, they were in breach of Section 4 of the *Interest Act* (Canada).

Section 4 provides that where a contract provides for interest at a rate or percentage that is less than a year, no interest exceeding 5 per cent will be recoverable unless the contract contains a statement of the yearly rate or percentage to which the other rate is equivalent. The loan agreements, but not the promissory notes, contained a simple formula for calculating the equivalent nominal annual rate.

Justice McEwen of the Ontario Superior Court of Justice held that the Administration Fee was not interest, but that the Discount Fee of .003 per cent per diem was interest and violated Section 4. In the result, the application judge interpreted Section 4 as capping the total interest payable on the loans at 5 per cent, effectively negating the stated base interest rate of 12 per cent per annum (24 per cent per annum after default).

The Court of Appeal allowed CEF's appeal. While the Court of Appeal agreed that the Discount Fee was interest, the annualizing formula in the loan agreements was sufficient compliance with Section 4. The Court of Appeal recognized the wide acceptance in commercial lending of formulae as sufficient compliance with Section 4.

Regarding the promissory notes, the Court agreed that the Discount Fee violated Section 4, but that the *Interest Act* had to be interpreted in light of modern commercial reality rather than on a strict literal reading. It was held that Section 4 only applied to the Discount Fee and that, as that Fee was already less than 5 per cent, the *Interest Act* had no effect.

The Court of Appeal was not prepared to adopt a strict interpretation that would lead to negating the bargain between the parties in order to provide a windfall to the borrower at the expense of the lender and contrary to the common intentions of the parties.

In the result, CEF was held entitled to 100 per cent of the interest and fees provided for in the loan agreements and promissory notes.

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